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Rep. Brad Miller: 'There is no chance that Congress would pass more TARP'

By Ezra Klein

I'd previously scheduled an interview with Rep. Brad Miller (D-N.C.) to talk about the financial regulation bill. But Miller is known as one of the House's leading experts on the mortgage market, so given the news of the day, our interview quickly focused on the crisis in foreclosures -- its effect on the economy and, in particular, on the big banks. We might be in a situation, Miller says, where the banks need another bailout, but there's no way they can get one. And what then?

An edited transcript of the interview follows.

Ezra Klein: **What's happened to the mortgage market? It's odd to say that the new foreclosure crisis is that the foreclosures have had to stop, but that's the new reality, right?**

Brad Miller: There is massive potential liability for the securitizers, which are mostly the biggest banks. The contract was that if mortgages didn't meet certain requirements, then the securitizer would buy them back. The mortgage servicers and trustees have exclusive control over the paperwork. Both the investors, the people who own the mortgage-backed securities, and the homeowners, really depend on them. There's been lots of litigation where investors try to get securitizers to buy back the bad mortgages because they were flawed, but that litigation has been stymied by procedural objections. If the private investors can break through that defense and require the mortgages that don't meet the requirements to be bought back, the liabilities for the biggest banks will be enormous.

EK: So this is, in other words, a problem for bank balance sheets. These banks bought the mortgages from individuals, packaged them into securities, and then sold them to investors. But because the mortgage contracts weren't valid, the investor can potentially force the banks to take the mortgages back, thus blowing a new hole in their balance sheets?

BM: Right. They'll have to buy them one mortgage at a time. Someone said there might be a second round of bank insolvencies because of this and there might need to be more TARP. There is no chance that Congress would pass more TARP.

EK: What does this mean for the economy? When people first hear about it, it almost sounds good. No more foreclosures? Great! Let the banks suffer for a while.

BM: It's kind of easy to take pleasure in all this and think the banks are being hoisted on their own petard, but it's all bad for the economy for the mortgage market to be in such turmoil, to not know whether the right to foreclose will be enforceable. It's a great deal of uncertainty and makes it much harder for private investors to get back into the mortgage market. It will probably make home buyers more uncertain because there'll be a lot of mortgage holders who are not going to be paying their mortgages or be foreclosed upon.

I don't think any member of Congress has been more critical of the Obama administration to do more about foreclosures. I introduced the cram-down legislation, I've written pieces saying TARP funds should be used to buy mortgages and modify them. I've been very vocal that the housing sector is an enormous part of our ongoing financial pain. But this does not accomplish the solution to the mortgage problem. It's hard even to see how it ends. But I've got to think it creates more uncertainty about the health of the banks. [Treasury] Secretary [Timothy] Geithner testified before the Financial Services Committee a few weeks ago and I asked him whether this litigation had been taken into account in the stress tests, and he said he wasn't sure. At the least, we now have resolution authority that we can take out for a spin.

EK: Granting that Congress won't touch anything like TARP, could it create any momentum behind addressing the housing market in a more systemic way? It seems to me that there'll eventually need to be some action to let banks work off their contracts, but at the same time, there's no way Congress can let the banks off the hook here without helping homeowners. What about something like "cram down," where homeowners can go to court to get their principal brought down?

BM: The politics of bankruptcy modification was that every Republican was against it, and then we lost a lot of Democrats. We got it through the House, but it had a lot of compromises, and it was very hard. It failed in the Senate. Senator [Richard] Durbin [D-Ill.] was its champion, and he says he thinks we'll eventually come back to it. He hates the term "cram down," by the way. But if we lose several seats in the Senate, it's hard to see them getting the votes to do that with every Republican being against it. I think we've got a terrible economic problem at a time in our politics when we have political paralysis.

EK: Originally, this interview was about something you said at a Roosevelt Institute conference last week, which was that we'd know if the financial regulations bill was working because bank profits would fall. Why is that your measure?

BM: It's really more an indicator than anything else. The growth of profits in the industry is an indication that something is wrong. When a market is working properly, it squeezes profits, squeezes cost. In a working market, you would not see the kind of compensation we've seen in that sector. You would not see the profits we saw in that sector. They were more than 40 percent of total corporate profits. Which really means that the switch for market forces was in the off position.

EK: That's not very intuitive to people, I think. Our shorthand for Wall Street is "the market." How can the market not be a working market?

BM: The asymmetry of information. The banks knew what was in the mortgages that homeowners were signing and the homeowners did not, and the banks knew what was in the mortgage-backed securities they were selling to investors and the investors did not. The asymmetry worked fabulously well for the parties with the information. If we created a market where the investors knew what they were buying and the homeowners knew what they were signing, the profits for the intermediaries would be dramatically lower.

EK: What's in the bill that you consider particularly important going forward? What are you watching and trying to protect?

BM: The front end, the consumer protection part, is more important to overall financial stability than it's been given credit for. We did get anti-predatory mortgage legislation into the bill. If the mortgage market is free of the type of abuses we saw in the last decade, that would be enormous. It's easy for people to say that the banks will find something else, but they won't find something like mortgages. Mortgages are by far the biggest asset. It's \$12 or \$14 trillion in debt. Credit card debt is \$800 billion. If money is not gushing into the financial system from homeowners, that will make a big difference. And I think the profitability is going to be an indicator of whether market sources are working and whether banks are taking big risks. The practices that led to the crisis in 2007 and 2008 were leading to huge profits in 2005 and 2006. If the profits get back up there, it might be a sign they're taking too much risk again.